U.S. OFFICE OF PERSONNEL MANAGEMENT
OFFICE OF THE INSPECTOR GENERAL
OFFICE OF AUDITS

Final Audit Report

Subject:

Audit of the Federal Employees Health Benefits Program Operations at Blue Choice

Report No. 1C-MK-00-10-005

Date: July 22, 2010

-- CAUTION --

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

Office of the
Inspector General

AUDIT REPORT

Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
Blue Choice
Contract Number CS 2506 - Plan Code MK
Rochester, New York

Report No. 1C-MK-00-10-005 **Date:** July 22, 2010

Michael R. Esser
Assistant Inspector General
for Audits

UNITED STATES OFFICE OF PERSONNEL MANAGEMENT
Washington, DC 20415

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EXECUTIVE SUMMARY

Federal Employees Health Benefits Program
Community-Rated Health Maintenance Organization
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Report No. 1C-MK-00-10-005 **Date:** July 22, 2010

The Office of the Inspector General performed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Blue Choice (Plan). The audit covered contract years 2006 through 2009 and was conducted at the Plan's office in Rochester, New York.

This report questions $2,486,049 for inappropriate health benefit charges to the FEHBP in contract years 2007, 2008, and 2009. The questioned amount includes $2,301,947 for defective pricing and $184,102 due the FEHBP for lost investment income, calculated through June 30, 2010. We found that the FEHBP rates were developed in accordance with the Office of Personnel Management's rules and regulations in 2006.

For contract years 2007 through 2009, we determined that the FEHBP's rates were overstated by $607,957 in 2007, $462,788 in 2008, and $1,231,202 in 2009 due to defective pricing. More specifically, the Plan did not apply a similarly sized subscriber group discount to the FEHBP's rates in each year in question.

Consistent with the FEHBP regulations and the contract, the FEHBP is due $184,102 for lost investment income, calculated through June 30, 2010, on the defective pricing findings. In addition, the contracting officer should recover lost investment income on amounts due for the period beginning July 1, 2010, until all defective pricing amounts have been returned to the FEHBP.

CONTENTS

I. INTRODUCTION AND BACKGROUND

Introduction

We completed an audit of the Federal Employees Health Benefits Program (FEHBP) operations at Blue Choice (Plan) in Rochester, New York. The audit covered contract years 2006 through 2009. The audit was conducted pursuant to the provisions of Contract CS 2506; 5 U.S.C. Chapter 89; and 5 Code of Federal Regulations (CFR) Chapter 1, Part 890. The audit was performed by the Office of Personnel Management's (OPM) Office of the Inspector General (OIG), as established by the Inspector General Act of 1978, as amended.

Background

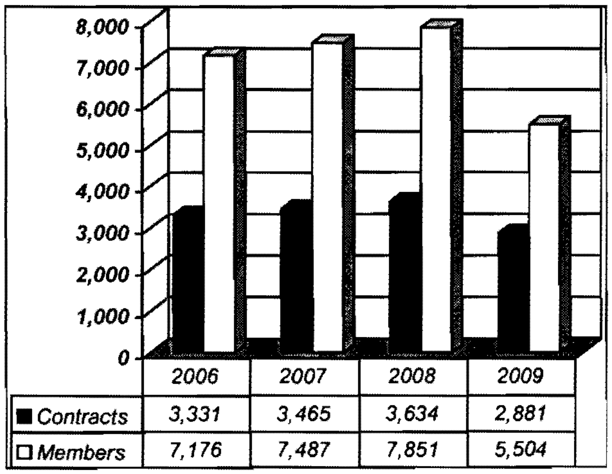
The FEHBP was established by the Federal Employees Health Benefits Act (Public Law 86-382), enacted on September 28, 1959. The FEHBP was created to provide health insurance benefits for federal employees, annuitants, and dependents. The FEHBP is administered by OPM's Retirement and Benefits Office. The provisions of the Federal Employees Health Benefits Act are implemented by OPM through regulations codified in Chapter 1, Part 890 of Title 5, CFR. Health insurance coverage is provided through contracts with health insurance carriers who provide service benefits, indemnity benefits, or comprehensive medical services.

Community-rated carriers participating in the FEHBP are subject to various federal, state and local laws, regulations, and ordinances. While most carriers are subject to state jurisdiction, many are further subject to the Health Maintenance Organization Act of 1973 (Public Law 93-222), as amended (i.e., many community-rated carriers are federally qualified). In addition, participation in the FEHBP subjects the carriers to the Federal Employees Health Benefits Act and implementing regulations promulgated by OPM.

The FEHBP should pay a market price rate, which is defined as the best rate offered to either of the two groups closest in size to the FEHBP. In contracting with community-rated carriers, OPM relies on carrier compliance with appropriate laws and regulations and, consequently, does not negotiate base rates. OPM negotiations relate primarily to the level of coverage and other unique features of the FEHBP.

The chart to the right shows the number of FEHBP contracts and members reported by the Plan as of March 31 for each contract year audited.

FEHBP Contracts/Members
March 31



The Plan has participated in the FEHBP since 1989 and provides health benefits to FEHBP members in the New York Counties of Monroe, Livingston, Wayne, Ontario, Seneca, and Yates. The last audit conducted by our office was a rate reconciliation audit and covered contract year 2005. All matters related to that audit have been resolved.

The preliminary results of this audit were discussed with Plan officials at an exit conference and in subsequent correspondence. A draft report was also provided to the Plan for review and comment. The Plan agrees with our findings. The Plan's comments were considered in the preparation of this final report and are included, as appropriate, as the Appendix.

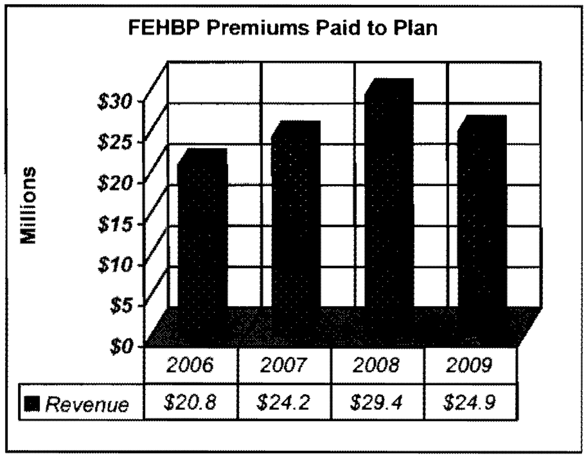
II. OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

The primary objectives of the audit were to verify that the Plan offered market price rates to the FEHBP and to verify that the loadings to the FEHBP rates were reasonable and equitable. Additional tests were performed to determine whether the Plan was in compliance with the provisions of the laws and regulations governing the FEHBP.

Scope

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



This performance audit covered contract years 2006 through 2009. For these contract years, the FEHBP paid approximately $99.3 million in premiums to the Plan. The premiums paid for each contract year audited are shown on the chart above.

OIG audits of community-rated carriers are designed to test carrier compliance with the FEHBP contract, applicable laws and regulations, and OPM rate instructions. These audits are also designed to provide reasonable assurance of detecting errors, irregularities, and illegal acts.

We obtained an understanding of the Plan's internal control structure, but we did not use this information to determine the nature, timing, and extent of our audit procedures. However, the audit included such tests of the Plan's rating system and such other auditing procedures considered necessary under the circumstances. Our review of internal controls was limited to the procedures the Plan has in place to ensure that:

- The appropriate similarly sized subscriber groups (SSSG) were selected;
- the rates charged to the FEHBP were the market price rates (i.e., equivalent to the best rate offered to the SSSGs); and
- the loadings to the FEHBP rates were reasonable and equitable.

In conducting the audit, we relied to varying degrees on computer-generated billing, enrollment, and claims data provided by the Plan. We did not verify the reliability of the data generated by the various information systems involved. However, nothing came to our attention during our audit testing utilizing the computer-generated data to cause us to doubt its reliability. We believe that the available data was sufficient to achieve our audit objectives. Except as noted above, the audit was conducted in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States.

The audit fieldwork was performed at the Plan's office in Rochester, New York, during October and November 2009. Additional audit work was completed at our field offices in Cranberry Township, Pennsylvania and Jacksonville, Florida.

Methodology

We examined the Plan's federal rate submissions and related documents as a basis for validating the market price rates. In addition, we examined the rate development documentation and billings to other groups, such as the SSSGs, to determine if the market price was actually charged to the FEHBP. Finally, we used the contract, the Federal Employees Health Benefits Acquisition Regulations (FEHBAR), and OPM's Rate Instructions to Community-Rated Carriers to determine the propriety of the FEHBP premiums and the reasonableness and acceptability of the Plan's rating system.

To gain an understanding of the internal controls in the Plan's rating system, we reviewed the Plan's rating system's policies and procedures, interviewed appropriate Plan officials, and performed other auditing procedures necessary to meet our audit objectives.

III. AUDIT FINDINGS AND RECOMMENDATIONS

Premium Rates

1. Defective Pricing $2,301,947

The Certificates of Accurate Pricing the Plan signed for contract years 2007, 2008, and 2009 were defective. In accordance with federal regulations, the FEHBP is therefore due a price adjustment for these years. Application of the defective pricing remedies shows that the FEHBP is entitled to premium adjustments totaling $2,301,947 (see Exhibit A). We found that the FEHBP rates were developed in accordance with the Office of Personnel Management's (OPM) rules and regulations for contract year 2006.

Federal Employee Health Benefits Acquisition Regulation (FEHBAR) 1652.215-70 provides that carriers proposing rates to OPM are required to submit a Certificate of Accurate Pricing certifying that the proposed subscription rates, subject to adjustments recognized by OPM, are market price rates. OPM regulations refer to a market price rate in conjunction with the rates offered to an SSSG. If it is found that the FEHBP was charged higher than a market price (i.e., the best rate offered to an SSSG), a condition of defective pricing exists, requiring a downward adjustment of the FEHBP premiums to the equivalent market price.

2007

We disagree with the Plan's selection of [redacted] as the SSSGs for contract year 2007. The Plan did not originally include experience rated preferred provider option (PPO) or point-of-service (POS) groups in its support for the 2007 SSSG selections. We obtained the enrollment data that included PPO and POS groups and determined that the 2007 SSSGs were [redacted]

Our analysis of the rates charged to the SSSGs shows that [redacted] received a [redacted] percent discount and [redacted] received a [redacted] percent discount. The Plan did not apply the [redacted] percent discount that [redacted] received to the FEHBP's rates in contract year 2007. Therefore, we re-developed the FEHBP's rates by applying the [redacted] percent discount to the line 5 rates. A comparison of the reconciled line 5 rates to our audited line 5 rates shows that the FEHBP was overcharged $607,957 in 2007 (see Exhibit B).

2008

We disagree with the Plan's selection of [redacted] as the SSSGs for contract year 2008. Again, the Plan did not originally include experience rated PPO or POS groups in its support for the 2008 SSSG selections. We obtained the enrollment data that included PPO and POS groups and determined that the 2008 SSSGs were [redacted]

Our analysis of the rates charged to the SSSGs shows that [redacted] did not receive a discount and [redacted] received a [redacted] percent discount. The Plan did not apply the [redacted] percent discount that RIT received to the FEHBP's rates in contract year 2008. Accordingly, we re-developed the FEHBP's rates by applying the [redacted] percent discount to the line 5 rates. A comparison of the reconciled line 5 rates to our audited line 5 rates shows that the FEHBP was overcharged $462,788 in 2008 (see Exhibit B).

2009

We disagree with the Plan's selection of [redacted] as the SSSGs for contract year 2009. As in previous years, the Plan did not originally include experience rated PPO or POS groups in its support for the 2009 SSSG selections. We obtained the enrollment data that included PPO and POS groups and determined that the 2009 SSSGs were [redacted]

Our analysis of the rates charged to the SSSGs shows that [redacted] received a [redacted] percent discount and [redacted] received a [redacted] percent discount. The Plan did not apply the [redacted] percent discount that [redacted] received to the FEHBP's rates in contract year 2009. Therefore, we re-developed the FEHBP's rates by applying the [redacted] percent discount to the line 5 rates. A comparison of the reconciled line 5 rates to our audited line 5 rates shows that the FEHBP was overcharged $1,231,202 in 2009 (see Exhibit B).

Recommendation 1

We recommend that the contracting officer require the Plan to return $2,301,947 to the FEHBP for defective pricing in contract years 2007, 2008, and 2009.

Plan's Comments:

The Plan concurs with the findings presented above, which reflect adjustments, based on the Plan's comments, to the 2008 calculated discount and amount overcharged.

2. Lost Investment Income **$184,102**

In accordance with the FEHBP regulations and the contract between OPM and the Plan, the FEHBP is entitled to recover lost investment income on the defective pricing findings due the FEHBP in contract years 2007, 2008, and 2009. We determined that the FEHBP is due $184,102 for lost investment income, calculated through June 30, 2010 (see Exhibit C). In addition, the FEHBP is entitled to lost investment income for the period beginning July 1, 2010, until all defective pricing finding amounts have been returned to the FEHBP.

FEHBAR 1652.215-70 provides that, if any rate established in connection with the FEHBP contract was increased because the carrier furnished cost or pricing data that were not complete, accurate, or current as certified in its Certificate of Accurate Pricing, the rate shall be reduced by the amount of the overcharge caused by the defective data. In addition, when the rates are reduced due to defective pricing, the regulation states that the government is entitled to a refund and simple interest on the amount of the overcharge from the date the overcharge was paid to the carrier until the overcharge is liquidated.

Our calculation of lost investment income is based on the United States Department of the Treasury's semiannual cost of capital rates.

Recommendation 2

We recommend that the contracting officer require the Plan to return $184,102 to the FEHBP for lost investment income for the period January 1, 2007 through June 30, 2010. In addition, we recommend that the contracting officer recover lost investment income on amounts due for the period beginning July 1, 2010, until all defective pricing amounts have been returned to the FEHBP.

Plan's Comments:

The Plan concurs.

IV. MAJOR CONTRIBUTORS TO THIS REPORT

Community-Rated Audits Group

[redacted] Auditor-In-Charge

[redacted] Auditor

[redacted] Auditor

[redacted] Chief

[redacted] Senior Team Leader

Exhibit A

Blue Choice
Summary of Questioned Costs

Defective Pricing Questioned Costs:	
Contract Year 2007	$607,957
Contract Year 2008	$462,788
Contract Year 2009	$1,231,202
Total Defective Pricing Questioned Costs	**$2,301,947**
Lost Investment Income	**$184,102**
Total Questioned Costs	**$2,486,049**

Exhibit B

Blue Choice
Defective Pricing Questioned Costs

2007 Contract Year

	Single	Family	
Plan's Reconciled Rates	[redacted]	[redacted]	
Audited Rates	[redacted]	[redacted]	
Biweekly Overcharge	[redacted]	[redacted]	
To Annualize:	[redacted]	[redacted]	
x March 31, 2007 Headcount	[redacted]	[redacted]	
x Pay Periods	26	26	
Subtotal	[redacted]	[redacted]	
Total 2007 Defective Pricing Questioned Costs	[redacted]	[redacted]	$607,957

2008 Contract Year

	Single	Family	
Plan's Reconciled Rates	[redacted]	[redacted]	
Audited Rates	[redacted]	[redacted]	
Biweekly Overcharge	[redacted]	[redacted]	
To Annualize:	[redacted]	[redacted]	
x March 31, 2008 Headcount	[redacted]	[redacted]	
x Pay Periods	26	26	
Subtotal	[redacted]	[redacted]	
Total 2008 Defective Pricing Questioned Costs			$462,788

2009 Contract Year - High Option

	Single	Family	
Plan's Reconciled Rates	[redacted]	[redacted]	
Audited Rates	[redacted]	[redacted]	
Biweekly Overcharge	[redacted]	[redacted]	
To Annualize:	[redacted]	[redacted]	
x March 31, 2009 Headcount	[redacted]	[redacted]	
x Pay Periods	26	26	
Subtotal	[redacted]	[redacted]	
Total 2009 - High Option Defective Pricing Questioned Costs			$1,043,365

2009 Contract Year - Standard Option

	Single	Family	
Plan's Reconciled Rates	[redacted]	[redacted]	
Audited Rates	[redacted]	[redacted]	
Biweekly Overcharge	[redacted]	[redacted]	
To Annualize:	[redacted]	[redacted]	
x March 31, 2009 Headcount	[redacted]	[redacted]	
x Pay Periods	26	26	
Subtotal	[redacted]	[redacted]	
Total 2009 - Standard Option Defective Pricing Questioned Costs			$187,837

Total 2009 Defective Pricing Questioned Costs	$1,231,202
Total Defective Pricing Questioned Costs	$2,301,947

Exhibit C

Blue Choice
Lost Investment Income

Year Audit Findings:	2007	2008	2009	June 30, 2010	Total
Defective Pricing	**$607,957**	**$462,788**	**$1,231,202**	**$0**	**$2,301,947**
Totals (per year):	$607,957	$462,788	$1,231,202	$0	$2,301,947
Cumulative Totals:	$607,957	$1,070,745	$2,301,947	$2,301,947	$2,301,947
Average Annual Interest Rate:	5.5000%	4.9375%	5.2500%	3.2500%	
Interest on Prior Years Findings:	$0	$30,018	$56,214	$37,407	$123,639
Current Years Interest:	$16,719	$11,425	$32,319	$0	$60,463
Total Cumulative Interest Through June 30, 2010	$16,719	$41,443	$88,533	$37,407	**$184,102**

APPENDIX

June 23, 2010

U.S. Office of Personnel Management
Office of the Inspector General
Attn: [redacted]
1900 E Street, NW
Room 6400
Washington, D.C. 20415-1100

Dear [redacted]

Enclosed is the response to the draft audit report issues May 11, 2010. For the covered years of 2006, 2007, and 2009 we have no objections to the findings detailed therein. For the 2008 plan year we have the following comments:

1) Benefit changes to the plan labeled "PPO C", worth [redacted] were not accounted for in the [redacted].
2) Benefit changes to the plan labeled "POS B" which [redacted]ecame "Custom POS 1", worth [redacted] were not accounted for in the analysis
3) Benefit changes to the plan labeled "POS D" which then became "Custom POS 2", worth [redacted] were not accounted for in the analysis
4) Starting 2007 Med D Rx rates are incorrect in the development.

Details supporting the changes listed above are attached for your consideration. Inclusion of these changes should place the final discount at [redacted] Upon adjustments of the calculated discount for 2008, we expect that there will also be a downward adjustment of the lost investment income calculation.

Please forward any questions to me at [redacted]

Sincerely,

[redacted]

Manager of Underwriting

Cc: [redacted]
Director Rating and Underwriting

[redacted]
Chief Underwriter

[redacted]
Internal Auditor

Edward DeHerde
Chief, Health Insurance Group III
Insurance Services Program